



12 CFR Part 231

[Regulation EE; Docket No. R – 1661]

RIN 7100-AF 48

Netting Eligibility for Financial Institutions

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board of Governors (Board) is publishing a final rule that amends Regulation EE to include additional entities in the definition of “financial institution” contained in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) so that they are covered by FDICIA’s netting protections. The final rule also clarifies certain aspects of the existing activities-based test in Regulation EE.

DATES: The final rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

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SUPPLEMENTARY INFORMATION:

I. Background

Sections 401-407 of FDICIA¹ provide certainty that netting contracts will be enforced, even in the event of the insolvency of one of the parties. These netting provisions apply to bilateral netting contracts between two financial institutions and multilateral netting contracts among members of a clearing organization.² FDICIA defines “financial

¹ Pub. L. 102-242; 105 Stat. 2236, 2372-3; 12 U.S.C. 4401-4407.

² FDICIA section 402(2) generally defines “clearing organization” to include entities that provide clearing, netting, and settlement services to their members and in which all members of the entity are themselves financial institutions or clearing organizations.

institution” as a broker or dealer, a depository institution, a futures commission merchant, or any other institution as determined by the Board.

Regulation EE expands the FDICIA definition of “financial institution”—and therefore expands FDICIA’s netting protections—using an activities-based test that includes a qualitative component and a quantitative component. The qualitative component requires that the person “represent, orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets.”³ A person that makes this representation demonstrates that it is willing to engage in transactions on both sides of the market and is, in effect, holding itself out as a market intermediary.⁴ The quantitative component requires that the person have either (1) one or more financial contracts of a total gross dollar value of at least \$1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates or (2) total gross mark-to-market positions of at least \$100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.⁵

On May 2, 2019, consistent with the purposes of FDICIA’s netting provisions, and in order to reduce systemic risk and increase efficiency in the financial markets, the Board proposed to amend Regulation EE to include additional categories of entities in the

However, certain entities qualify as clearing organizations under FDICIA section 402(2)—and are therefore eligible for the multilateral netting protections under FDICIA section 404—without regard to whether all of their members qualify as financial institutions or clearing organizations. Specifically, an entity automatically qualifies as a clearing organization if it is (1) registered with the Securities and Exchange Commission (SEC) as a clearing agency or has been exempted from registration by the SEC or (2) registered with the Commodity Futures Trading Commission (CFTC) as a derivatives clearing organization or has been exempted from registration by the CFTC.

³ 12 CFR 231.3(a). Regulation EE generally defines the term “financial contract” by reference to the term “qualified financial contract” under section 11(e)(8)(D) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(e)(8)(D). 12 CFR 231.2(c).

⁴ 59 FR 4780, 4782 (February 2, 1994).

⁵ *Id.*

definition of financial institution.⁶ The Board also proposed to clarify certain aspects of Regulation EE’s existing activities-based test for qualifying as a financial institution.

II. Public Comments

The Board received five responsive comments from private-sector financial institutions, industry associations, and an international organization. Commenters supported the proposed revisions to Regulation EE and, in some cases, suggested additional revisions. Several commenters suggested that the Board extend the financial institution definition to additional categories of entities. One commenter suggested that the Board make two minor clarifications related to the proposed changes to the activities-based test.

A. Qualification as a Financial Institution Based on Type of Entity

The Board is amending Regulation EE to include in the definition of financial institution the entities identified in the proposal. Additionally, the Board is including two other categories of entities, as well as the Bank for International Settlements (BIS), in the definition of financial institution.

The Board proposed to define the following entities as financial institutions: swap dealers and security-based swap dealers;⁷ major swap participants (MSPs) and major security-based swap participants (MSBSPs);⁸ nonbank financial companies that the Financial Stability Oversight Council (FSOC) has determined shall be supervised by the Board and subject to prudential standards (nonbank systemically important financial

⁶ 84 FR 18741 (May 2, 2019). FDICIA section 402(9) defines the term “financial institution” to include an enumerated list of entities and “any other institution as determined by the Board of Governors of the Federal Reserve System.”

⁷ See 7 U.S.C. 6s (swap dealer registration requirement) and 17 CFR 1.3 (swap dealer definition and de minimis thresholds); 15 U.S.C. 78o–10 (security-based swap dealer registration requirement) and 17 CFR 240.3a71–1 and 240.3a71–2 (security-based swap dealer definition and de minimis thresholds).

⁸ See 7 U.S.C. 6s (MSP registration requirement) and 15 U.S.C. 78o–10 (MSBSP registration requirement).

institutions, or SIFIs);⁹ derivatives clearing organizations (DCOs) that are registered with the CFTC or have been exempted from registration by the CFTC;¹⁰ clearing agencies that are registered with the SEC or have been exempted from registration by the SEC;¹¹ financial market utilities that the FSOC has designated as, or as likely to become, systemically important (designated financial market utilities, or DFMUs);¹² foreign banks as defined in the International Banking Act;¹³ bridge institutions established for the purpose of resolving financial institutions; and Federal Reserve Banks. Commenters supported extending the financial institution definition to the entities identified in the proposal.

The Board believes that adding these entities to the definition of financial institution would promote the purposes of FDICIA's netting provisions—namely to reduce systemic risk and increase efficiency in the financial markets. The Board recognizes that Congress has imposed or expanded federal supervision and regulation for many of these entities since the Board first promulgated Regulation EE. In subjecting these entities to higher levels of regulation and supervision due to their activities, transaction volumes, and risks presented to the financial markets, Congress indicated the importance of the smooth functioning of these entities to the financial markets. Accordingly, the Board is finalizing its proposal to extend the financial institution definition to include swap dealers, security-based swap dealers, MSPs, MSBSPs, nonbank SIFIs, DCOs, clearing agencies, DFMUs, foreign banks, bridge institutions established for the purpose of resolving financial institutions, and Federal Reserve Banks.

⁹ 12 U.S.C. 5323.

¹⁰ *See* 7 U.S.C. 7a–1(a) and (h).

¹¹ *See* 15 U.S.C. 78q–1(b) and (k).

¹² 12 U.S.C. 5463.

¹³ 12 U.S.C. 3101. As described in the proposal, the Board believes that foreign banks qualify as financial institutions under FDICIA's statutory definition.

The Board is also amending Regulation EE to define qualifying central counterparties (QCCPs), foreign central banks, and the BIS as financial institutions.

1. QCCPs

In the preamble to the proposed rule, the Board requested comment on whether it should include in the definition of financial institution an entity that is a QCCP under the Board's Regulation Q.¹⁴ One industry association supported this addition.

The Board's Regulation Q establishes criteria for identifying QCCPs. Generally, a Board-supervised institution that clears financial transactions through a QCCP can receive preferential capital treatment for those transactions.¹⁵ To qualify as a QCCP, an entity based outside the United States must generally (among other things) be subject to home-country risk-management standards that are comparable to those that apply to DFMUs.

As noted above, the Board is amending the definition of financial institution to include DCOs and clearing agencies that are registered with, or have been exempted from registration by, the CFTC or SEC. All domestic QCCPs and many foreign-based QCCPs are registered or exempt DCOs/clearing agencies. To ensure that all foreign-based QCCPs qualify as financial institutions for purposes of FDICIA's netting provisions, the Board is amending Regulation EE to extend the financial institution definition to QCCPs. The Board believes that defining QCCPs to be financial institutions would benefit financial markets that rely on FDICIA's netting provisions by ensuring that foreign-based QCCPs can participate in *other* financial market utilities that require participants to be financial institutions and that including QCCPs would meet the statutory objectives of reducing systemic risk and increasing efficiency in those financial markets. Additionally, the Board believes that it is appropriate to extend the financial institution definition to QCCPs

¹⁴ 12 CFR 217.2.

¹⁵ Exposures to a QCCP are risk-weighted at either 2 or 4 percent (*see* 12 CFR 217.35(b)(3) and (c)(3)), whereas exposures to a CCP that is not a QCCP are risk-weighted based on the risk weight otherwise assignable to the CCP.

because Regulation Q (1) establishes criteria for identifying QCCPs and (2) provides that an entity must meet heightened risk-management standards to qualify as a QCCP.

2. Foreign central banks

A private-sector financial institution and an international organization suggested that the Board include foreign central banks in the definition of financial institution. These commenters stated that foreign central banks are systemically important and that extending the financial institution definition to cover foreign central banks would reduce systemic risk and increase efficiency in the financial markets, consistent with the purpose of the proposal.

The Board understands that foreign central banks, like Federal Reserve Banks, may participate in financial markets through various types of transactions that are used to implement monetary policy. The Board believes that including foreign central banks categorically in the definition of financial institution may benefit financial markets that rely on FDICIA and would meet the statutory objectives of reducing systemic risk and increasing efficiency in those financial markets. Furthermore, given that the Board is amending Regulation EE to define Federal Reserve Banks as financial institutions, the Board believes that a parallel addition of foreign central banks would be appropriate. Accordingly, the Board is amending Regulation EE to define foreign central banks as financial institutions.

3. The BIS

Multiple commenters suggested that the Board include the BIS in the definition of financial institution. The BIS's shareholders are central banks and monetary authorities that are members of the BIS.¹⁶ The BIS engages in financial contracts (e.g., foreign exchange derivatives) to help central banks and other official monetary institutions

¹⁶ See <https://www.bis.org/about/index.htm>.

manage their foreign exchange reserves.¹⁷ Because the BIS engages in market-facing financial contracts and has characteristics similar to those of the Federal Reserve Banks and foreign central banks, the Board believes that the BIS should receive financial institution status, which is also being extended to the Federal Reserve Banks and foreign central banks. The Board believes that extending financial institution status to the BIS would meet the statutory objectives of reducing systemic risk and increasing efficiency in the financial markets. Accordingly, the Board is amending Regulation EE to define the BIS as a financial institution.

4. Other categories of entities

Two private-sector financial institutions and one international organization requested that the Board add the following categories of entities to the definition of financial institution: (i) supranational institutions, such as multilateral development banks; (ii) foreign systemically important financial market infrastructures that are subject to the Principles for Financial Market Infrastructures¹⁸ as implemented in their respective jurisdictions, and their operators; (iii) sovereign wealth funds; and (iv) electronic money institutions and payment institutions. The commenters did not provide detailed explanations for why the Board should extend financial institution status to these categories of entities.

As discussed above, the domestic and global landscape for financial regulation has changed dramatically since the Board promulgated Regulation EE. In particular, several types of entities are now subject to expanded federal supervision and regulation. In subjecting these types of entities to higher levels of regulation and supervision due to their activities, transaction volumes, and risks presented to the financial markets, Congress

¹⁷ See <https://www.bis.org/banking/finserv.htm>.

¹⁸ See <https://www.bis.org/cpmi/publ/d101.htm>.

indicated the importance of the smooth functioning of these entities to the financial markets.

The Board is not extending the financial institution definition to include the four categories of entities suggested by commenters. It is not clear the extent to which these types of entities, as categories, are active in financial contract netting such that the smooth functioning of their netting contracts is important for reducing systemic risk within the U.S. banking system or financial markets. Additionally, it is not clear the extent to which some of these entities function as market intermediaries. The Board notes that some foreign systemically important financial market infrastructures may be captured by other newly-added categories in the definition of financial institution, including DCOs, clearing agencies, and QCCPs.

As the Board noted in the proposed rule, it has the authority to issue case-by-case determinations for individual entities seeking financial institution status. Further, while the Board is not categorically defining all of the entities described above as financial institutions, individual entities in these categories might independently qualify as financial institutions under Regulation EE's activities-based test.

B. Activities-based test

The quantitative component of the activities-based test requires that a person have either (1) one or more financial contracts of a total gross dollar value of at least \$1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates or (2) total gross mark-to-market positions of at least \$100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.¹⁹

¹⁹ 12 CFR 231.3(a). The Bankruptcy Code includes a test for identifying "financial participants" that is substantively identical to the quantitative test in Regulation EE. 11

The Board proposed to clarify how the quantitative component of the activities-based test would apply following a consolidation of legal entities. Specifically, the Board proposed that, upon the consolidation of two or more entities, the surviving entity may aggregate the total gross dollar value of notional principal amounts outstanding or the total gross mark-to-market positions of both entities on each calendar day during the previous 15-month period, and such total amounts would be used to determine whether the surviving entity meets the quantitative thresholds of the activities-based test. The Board did not receive any responsive comments on this clarification and is adopting the clarification as proposed.

The Board also proposed to add language to clarify, consistent with its current understanding, that the “previous 15-month period” described in the activities-based test includes the day on which a person evaluates whether it meets the relevant thresholds in the quantitative component of the activities-based test. Specifically, the Board proposed to add the words “at such time” to proposed §§ 231.3(a)(1) and (a)(2) to clarify that a person can qualify as a financial institution under the activities-based test if (1) the person’s positions exceeded one of the quantitative threshold on any prior day within the previous 15-month period *or* (2) the person’s positions exceed one of the quantitative thresholds on the day the person evaluates its status as a financial institution. One commenter requested that the Board confirm that the proposed clarification is not intended to modify the settled understanding that the “previous 15-month period” includes the day on which a party evaluates its status as a financial institution. The Board is adopting the

U.S.C. 101(22A). Under the Bankruptcy Code, financial participants that enter into certain types of financial contracts and master netting agreements for those financial contracts are exempt from provisions of the Bankruptcy Code that might otherwise delay or prevent netting related to those contracts. *See, e.g.*, 11 U.S.C. 362(b)(6), (7), (17), and (27) (specifying that the Bankruptcy Code’s automatic stay does not prevent a financial participant from exercising a contractual right to, *inter alia*, “offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with” certain types of financial contracts and master netting agreements for those financial contracts).

proposed clarification, and confirms that a person can qualify as a financial institution under the activities-based test if the person's positions exceed one of the quantitative thresholds on the day the person evaluates its status as a financial institution.

A commenter also requested clarification that satisfying the qualitative component of the activities-based test (which requires that a person "represent[], orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets"²⁰) does not affect a person's regulatory status for any other purpose. The Board confirms that satisfying the qualitative component of the activities-based test does not affect a person's regulatory status for any other purpose.

IV. Regulatory Analysis

A. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3506; 5 CFR part 1320, Appendix A.1), the Board may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a valid Office of Management and Budget (OMB) control number. The Board reviewed the final rule under the authority delegated to the Board by the OMB and determined that it contains no collections of information under the PRA.²¹ Accordingly, there is no paperwork burden associated with the rule.

B. Regulatory Flexibility Act

In accordance with section 4 of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.*, the Board is publishing a final regulatory flexibility analysis for the final rule. The RFA generally requires an agency to assess the impact a rule is expected to have on small entities. The RFA requires an agency either to provide a regulatory flexibility analysis or

²⁰ 12 CFR 231.3(a). Regulation EE generally defines the term "financial contract" by reference to the term "qualified financial contract" under section 11(e)(8)(D) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(e)(8)(D). 12 CFR 231.2(c).

²¹ See 44 U.S.C. 3502(3).

to certify that the final rule will not have a significant economic impact on a substantial number of small entities. The Small Business Administration (SBA) has adopted small entity size standards which generally provide that financial entities are “small entities” only if they have (1) at most, \$41.5 million or less in annual receipts or (2) for depository institutions and credit card issuers, \$600 million or less in assets.²²

The Board did not receive any comments on its initial regulatory flexibility analysis. The Board certifies that the final rule will not have a significant economic impact on a substantial number of small entities. The final rule extends the “financial institution” definition to swap dealers, security-based swap dealers, MSPs, MSBSPs, DCOs, clearing agencies, QCCPs, bridge institutions, Federal Reserve Banks, foreign central banks, and the BIS.²³

The Board has previously determined that designated financial market utilities are not small entities;²⁴ the CFTC has previously determined that swap dealers, MSPs, and DCOs are not small entities;²⁵ and the SEC has previously determined that security-based swap dealers, MSBSPs, and clearing agencies are not small entities.²⁶ The Federal Reserve Banks are not small entities.²⁷ Similarly, the Board does not believe that foreign central banks or the BIS would be small entities. All domestic QCCPs are registered as DCOs and/or clearing agencies and, accordingly, are not small entities. Certain foreign-

²² 13 CFR 121.201, sector 52 (SBA small entity size standards for finance and insurance entities).

²³ As explained above, the final rule also codifies the Board’s existing view that foreign banks are financial institutions.

²⁴ 79 FR 65543, 65556 (Nov. 5, 2014).

²⁵ *See, e.g.*, 81 FR 80563, 80565 (Nov. 16, 2016); 76 FR 69334, 69428 (Nov. 8, 2011).

²⁶ *See, e.g.*, 81 FR 29959, 30142 (May 3, 2016); 81 FR 70744, 70784 (Oct. 13, 2016).

²⁷ None of the industry codes in the SBA’s small entity size standards necessarily apply to the Federal Reserve Banks *per se*, but the SBA’s size standards for commercial depository institutions are instructive. Generally, the SBA’s size standards provide that depository institutions are small entities if they have \$600 million or less in assets. 13 CFR 121.201, sector 52. Each of the Federal Reserve Banks holds significantly more than \$600 million in assets. *See* the Statement of Condition of Each Federal Reserve Bank, <https://www.federalreserve.gov/releases/h41/current/h41.htm#h41tab10a>.

based QCCPs are not registered as DCOs or clearing agencies, but these foreign-based QCCPs function similarly to DCOs and clearing agencies and—like DCOs and clearing agencies—are unlikely to be small entities.

Similarly, a bridge financial company would not be a small entity.²⁸ Under U.S. law, the Federal Deposit Insurance Corporation (FDIC) can establish a bridge financial company when it acts as receiver for a failing financial company. In order for the FDIC to be appointed as receiver for a financial company, the Secretary of the Treasury must determine that, *inter alia*, “the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States.”²⁹ The failure of a financial company that is a “small entity” would not affect financial stability in the United States.³⁰ Accordingly, the FDIC would not act as receiver—and would not form a bridge financial company—for a small entity. It is therefore unlikely that a bridge financial company would be a small entity. Similarly, it is unlikely that a foreign bridge institution established to facilitate the resolution of a foreign nonbank financial institution would be a small entity.

Foreign banks (including bridge banks) are already covered by FDICIA’s statutory definition of financial institution. Accordingly, while this final rule clarifies that foreign banks are financial institutions, it will not have any economic impact on foreign banks.

List of Subjects in 12 CFR Part 231

Banks, banking, financial institutions, netting.

²⁸ A bridge depository institution might be a small entity, but this final rule would not affect the status of bridge depository institutions under FDICIA because (as noted above) such institutions qualify as “financial institutions” under FDICIA’s statutory definition.

²⁹ 12 U.S.C. 5383(b)(2).

³⁰ See 13 CFR 121.201, sector 52 (Small Business Administration small entity size standards for finance and insurance entities), which generally provides that financial entities are “small entities” only if they have (1) at most, \$41.5 million or less in annual receipts or (2) for depository institutions and credit card issuers, \$600 million or less in assets.

For the reasons set forth in the preamble, the Board amends Regulation EE, 12 CFR part 231, as follows:

PART 231 – NETTING ELIGIBILITY FOR FINANCIAL INSTITUTIONS
(REGULATION EE)

1. The authority citation for part 231 continues to read as follows:

Authority: 12 U.S.C. 4402(1)(B) and 4402(9).

2. In § 231.2, redesignate paragraphs (c) through (f) as paragraphs (d) through (g), and add new paragraph (c) to read as follows:

§ 231.2—Definitions.

* * * * *

(c) Bridge institution means a legal entity that has been established by a governmental authority to take over, transfer, or continue operating critical functions and viable operations of an entity in resolution. A bridge institution could include a bridge depository institution or a bridge financial company organized by the Federal Deposit Insurance Corporation in accordance with 12 U.S.C. 1821(n) or 5390(h), respectively, or a similar entity organized under foreign law.

3. Amend § 231.3 by:

- a. Revising paragraph (a);
- b. Redesignating paragraphs (b) and (c) as paragraphs (c) and (d);
- c. Adding new paragraphs (b) and (e).

The revision and additions read as follows:

§ 231.3—Qualification as a financial institution.

(a) A person qualifies as a financial institution for purposes of sections 401-407 of the Act if it represents, orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and either—

(1) Had one or more financial contracts of a total gross dollar value of at least \$1 billion in notional principal amount outstanding at such time or on any day during the previous 15-month period with counterparties that are not its affiliates; or

(2) Had total gross mark-to-market positions of at least \$100 million (aggregated across counterparties) in one or more financial contracts at such time or on any day during the previous 15-month period with counterparties that are not its affiliates.

(b) After two or more persons consolidate, such as through a merger or acquisition, the surviving person meets the quantitative thresholds under paragraphs (a)(1) and (a)(2) if, on the same, single calendar day during the previous 15-month period, the aggregate financial contracts of the consolidated persons would have met such quantitative thresholds.

* * * * *

(e) A person qualifies as a financial institution for purposes of sections 401–407 of the Act if it is—

(1) A swap dealer or major swap participant registered with the Commodity Futures Trading Commission pursuant to section 4s of the Commodity Exchange Act (7 U.S.C. 6s);

(2) A security-based swap dealer or major security-based swap participant registered with the U.S. Securities and Exchange Commission pursuant to section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10);

(3) A derivatives clearing organization registered with the Commodity Futures Trading Commission pursuant to section 5b(a) of the Commodity Exchange Act (7 U.S.C. 7a-1(a)) or a derivatives clearing organization that the Commodity Futures Trading Commission has exempted from registration by rule or order pursuant to section 5b(h) of the Commodity Exchange Act (7 U.S.C. 7a-1(h));

(4) A clearing agency registered with the U.S. Securities and Exchange Commission pursuant to section 17A(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(b)) or a clearing agency that the U.S. Securities and Exchange Commission has exempted from registration by rule or order pursuant to section 17A(k) of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1(k));

(5) A financial market utility that the Financial Stability Oversight Council has designated as, or as likely to become, systemically important pursuant to 12 U.S.C. 5463;

(6) A qualifying central counterparty under 12 CFR 217.2;

(7) A nonbank financial company that the Financial Stability Oversight Council has determined shall be supervised by the Board and subject to prudential standards, pursuant to 12 U.S.C. 5323;

(8) A foreign bank as defined in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101), including a foreign bridge bank;

(9) A bridge institution established for the purpose of resolving a financial institution;

(10) A Federal Reserve Bank or a foreign central bank; or

(11) The Bank for International Settlements.

By order of the Board of Governors of the Federal Reserve System, February 17, 2021.

Ann Misback,

Secretary of the Board

[FR Doc. 2021-03596 Filed: 2/25/2021 8:45 am; Publication Date: 2/26/2021]